

This record is a partial extract of the original cable. The full text of the original cable is not available.

UNCLAS SECTION 01 OF 03 MANILA 000064

SIPDIS

Sensitive

STATE FOR EAP/EP, EB/IFD, E
STATE ALSO PASS FED RESERVE SAN FRANCISCO
STATE ALSO PASS USAID FOR AA/ANE and AA/G
TREASURY FOR OASIA

E.O. 12958: N/A

TAGS: [EFIN](#) [PGOV](#) [EINV](#) [RP](#)

SUBJECT: Stock Exchange Growing But Reforms Needed to
Boost Credibility

Sensitive but Unclassified - Not for Internet - Protect
Accordingly.

Summary

[11.](#) (SBU) The Philippine Stock Exchange is implementing reforms to restore investor confidence shattered from a market manipulation scandal in 2001-02. The composite index extended its three-year bull run with 15 percent growth in 2005 and a significant rise in daily turnover. PSE President Lim is working to increase small investor participation in the market and tap the vast amount of remittances by Overseas Filipino Workers. More fundamental reforms are needed, however, to overcome continued investor wariness. End Summary.

Stock Exchange Continues Bull Run

[12.](#) (U) The Philippine Stock Exchange composite index (Phisix) continued its strong growth, ending 2005 substantially higher than it began in spite of political turbulence the second half of the year. The Phisix, which consists of 30 local blue chip companies, gained 15 percent, with an average daily turnover often double and triple the 2004 level for much of the year. (Note: Even at its peak of \$34 million per day in early 2005, however, the PSE's turnover was just 15% that of the Indonesian stock market and 5% that of Thailand's. End Note.) Analysts polled by a local business newspaper predicted the Phisix would hit 2600 this year, reflecting its three-year average growth rate of 28 percent.

[13.](#) (SBU) The renewed vigor of the Philippine Stock Exchange (PSE) is reflected in the demand for shares of newly-listed companies. The overwhelming success of the initial public offering (IPO) by Manila Water in March 2005, the first in the Philippines since 1997, was surprising. More than 120 international investors demanded 15 times the offer size of \$88 million. SM Investment also drew keen interest for its \$500 million offering later in the year. (Note: Six other IPOs in the pipeline for 2005, however, were postponed or canceled unexpectedly, an issue Lim did not address. End Note.) IPOs expected to attract significant investor interest this year include the Lopez-owned power producer First Generation, which will test the market for \$200 million in February, followed by Shell Philippines, National Book Store, and United Laboratories. UBS Bank commented at a recent investment conference in the Philippines that equities listed on the PSE are undervalued and primed for continued growth compared to other Southeast Asian bourses.

Restoring Investor Confidence

[14.](#) (SBU) In a meeting January 4, PSE President and CEO Francis Lim told Econoff that the PSE was still suffering a lack of credibility following market manipulation by the company BWU, in 2001-02. BWU stock grew from 22 centavos to 107 pesos, nearly a 50-fold increase, in just four months. Investor interest soared based in part of false rumors that the Hong Kong shipping and gambling magnate Stanley Ho was tipping BWU for a multi-million dollar project. The investigation later uncovered links to former President Joseph Estrada. Even today, the Phisix and average daily turnover are still not even half of their peak levels of the late 1990s. Lim said investors are still concerned about insider trading and market manipulation, especially since no one from BWU was ever arrested and charged in this clear-cut case of defrauding the public.

15. (U) Lim said the PSE has worked hard to restore investor confidence by working with the Securities and Exchange Commission (SEC) to revise Disclosure Rules. Under the new rules, approved by the SEC in 2004, company compliance officers must meet the "10 minute rule" in informing the PSE about new information that could affect share prices so it can be posted on the web (www.pse.com). In addition, the PSE prohibited "selective disclosure" of material information to members of a group without informing others. The PSE also instituted a "blackout" provision on directors or principal officers not to conduct security trading until at least two full trading days after information becomes public.

16. (U) Lim noted that the PSE is still 52% owned by brokers. Although down from 100% broker-ownership at its founding in 1992, an executive order limits individual company and single industry ownership of the PSE to no more than 20%. As a result, the broker percentage of ownership must be reduced much further in the coming year.

Reaching out to Small Investors

17. (U) Lim said another of his initiatives is to increase the percentage of shares owned by small and local investors. Foreigners make up 50-70% of the daily turnover at the PSE. Although this indicates strong interest from international portfolio managers of new and emerging markets, the PSE would gain stability and strength from greater domestic investment. To that end, Lim has promoted programs for investor education and investor protection, and marketed the efforts of the PSE to safeguard rights. Through the Small Investor Program, 10% of the shares in a newly listed company must go to small investors - those with share values less than 25,000 pesos (\$500). The PSE also requires a minimum of 1000 shareholders for large company listings.

18. (SBU) Lim said he expanded the Marketing Department and tasked it to find ways to attract investment from Overseas Filipino Workers who are remitting over \$10 billion annually to the Philippines but putting little of it in the stock market. He also bemoaned the practice of asset management firms of limiting investments in equities to 10% or less of their account portfolios. (For example, the Asset Management and Trust Group that handles the investments for the U.S. Embassy's FSN Retirement Fund only added stocks to its investment portfolio mix in August 2005 but kept the equities at 5% of the total investment.)

19. (SBU) Another measure Lim encouraged during his tenure at PSE is the emergence of a Market Integrity Board to oversee broker compliance with stock exchange rules. Lim said brokers are notorious worldwide for cutting corners on certain regulations. The MIB (jokingly referred to as Men in Black) has worked to improve compliance by rewarding proper behavior and meting out infractions. The MIB is composed of 12 individuals, including a former Supreme Court Justice and a former chairman of the Securities and Exchange Commission. Through the efforts of MIB, broker compliance has increased by 60% since the program began based on annual audits, Lim said.

110. (U) The Philippines used to have two separate stock exchanges - one for Manila and one for Makati housed in different locations. Lim said former President Fidel Ramos forced their merger about ten years ago. The PSE now consists of two trading floors with identical company listings. Lim said he is trying to consolidate the two trading venues into one to save over 13 million pesos a month in overhead expenses. Eventually, he hopes to have floorless stock exchange, but admitted it may be difficult to convince brokers to go virtual.

Investment Board Requires Listing

111. (U) While the PSE is encouraging investment in the exchange, the GRP, particularly the Philippines Board of Investment (BOI), is trying to expand the number of listings. According to BOI Attorney Marjorie Ramos, under the Omnibus Investment Code (Executive Order 226) the Board of Investment can require firms, "when considered desirable and feasible," to list their shares on the PSE or offer them directly to the public or its employees. There may be deferments, the requirement can be suspended under certain conditions, and there may be circumstances in which the firm has "substantially complied" with the requirement. But in most cases the

firms must offer for sale or distribution a minimum of 10% of its shares within ten years after receiving investment incentives.

Comment

12. (SBU) Despite the rising index and higher daily turnover, the PSE is still on the periphery of investor interest, dwarfed by investor interest in the government bond market. While the PSE has made limited progress on issues such as divestiture, it must undertake and implement more fundamental reforms, such as implementing a market surveillance program and requiring risk-based capital management. The PSE must also strive to enhance its role as an independent regulator with increased autonomy of the Board of Directors. Although Lim should be commended for the reforms instituted during his tenure, PSE recalcitrance to push ahead with basic reforms of how the stock exchange operates will cause continued investor wariness and PSE domination by institutional and large investors.
Jones